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SUBJECT: SERBIA: BLAME GAME BETWEEN THE GOVERNMENT AND CENTRAL BANK
ON DINAR DEPRECIATION

SUMMARY

11. (SBU) Serbia's National Bank (NBS) Governor has been severely criticized over the relatively mild 3% depreciation of the Serbian dinar since the end of November 2009. The criticism, coming from both businesses and government officials, including most recently the Prime Minister, has fueled further speculation regarding the strength of the dinar and the ability of the NBS and Government to harmonize an effective monetary policy. End Summary.

Prime Minister Blames NBS

12. (U) Prime Minister Cvetkovic publicly criticized NBS Governor Radovan Jelasic on January 13, stating that the NBS should be held responsible for the weakening of the dinar and claiming that state policies and actions had in no way influenced the dinar's depreciation. Cvetkovic said the NBS should have predicted the increased demand for euros to pay end of year obligations and should have stabilized the dinar via stronger and timelier interventions. "I expect that the NBS, as an independent institution as well as the Government's partner in creating economic policies, would consistently implement monetary policy goals, and that NBS representatives would not throw responsibility for their own flaws on the Government," Cvetkovic said.

The Dinar's Slide

13. (SBU) Since late November 2009, Serbia's dinar has depreciated 3%. The dinar's slide from 94.44 dinars to the euro on November 25, 2009 to 97.33 dinars/euro on January 14, 2010 leaves it perilously close to the psychological and politically charged barrier of 100 dinars/euro. Following the signing of the \$4 billion IMF package with Serbia in May 2009, the dinar had been strengthening against Euro. This strengthening slowed and then began to slide in September 2009. The drop, however, became more severe in late November 2009. The NBS, which had not entered the forex market since February 2009, intervened in December 2009 and January 2010, selling a total of 170 million euros (\$233 million) to prop up the dinar. As of January 14, the NBS still had a record amount of currency reserves, totaling \$15.1 billion.

Business Sector's Fury

14. (SBU) In November and December 2009, Serbian business leaders also accused Jelasic of ruining corporate profits by permitting the dinar to depreciate and not intervening more aggressively in the forex market. In early December 2009, the Serbian Chamber of Commerce and Serbia's elite business leaders' Privrednik Club complained publicly that business profits had been badly hurt by the weakening dinar's impact on dinar-denominated invoices and on businesses' Euro-denominated obligations toward banks. The business groups urged the NBS to more aggressively use its currency reserves to defend the exchange rate and to provide a "stable currency".

15. (SBU) Governor Jelasic responded to business sector complaints that because the dinar floated freely rather than being fixed, fluctuations were to be expected. Frustrated over the attacks, Jelasic told us on December 15 that he would not fulfill anybody's

wishes on setting a specific exchange rate level. After Jelasic initially refused to meet with them, businessmen finally met with Prime Minister Cvetkovic and Governor Jelasic on December 22, 2009, to discuss the exchange rate and to attempt to soothe growing tensions. However, on January 13, 2010 the President of Belgrade's Chamber of Commerce, Milan Jankovic, blamed Governor Jelasic not only for the depreciation but also for Serbia having "the highest inflation in the region, the highest main interest rate, the most expensive loans, the lowest exports, and the most profitable banks," whom he accused of solely purchasing NBS securities rather than providing real investment.

NBS Governor: Blame the Government

16. (SBU) On January 5, Jelasic accused the government of a "rapid increase in spending that exerted pressure on the exchange rate." He said the government's decision to sell some of the \$600 million in IMF special assistance funds in December 2009 to finance the deficit had caused the devaluation, because the GOS had to expand the dinar monetary supply to complete the exchange, thus pumping additional dinars into the economy. Jelasic said on January 15 that the amount of funds was itself not the problem, but rather the speed with which this was done by the government.

The Government Strikes Back

17. (SBU) On January 11, Finance Minister Diana Dragutinovic rejected the Governor's blame, claiming that the exchange rate slide had started in October and that Serbia's 2009 deficit was actually lower than projections (\$1.39 billion versus the projected \$1.57 billion). Belgrade Mayor and Democratic Party Vice President Dragan Djilas also rejected government responsibility for the dinar on January 12, claiming that the NBS was to blame. Djilas said the city's budget had suffered a \$43.5 million loss in just one month due to the dinar's fall. Governor Jelasic responded on January 13 that politicians should not deal with the "serious business" of monetary policy and stressed that price stability was in the

interest of NBS. Jelasic's comments then prompted PM Cvetkovic's strongly worded January 13 statement.

Cooperation Needed Instead of Accusations

18. (U) Stojan Stamenkovic, an economist with Belgrade's Economic Institute, said on January 12 that the government and the NBS should harmonize their actions instead of accusing one another. The drop in the dinar was caused by bad timing of the actions of both, he said. On December 29, the NBS decreased both hard currency reserve requirements and the benchmark interest rate from 10% to 9.5%, thus decreasing the attractiveness of the dinar. Simultaneously, the Government had pumped in dinars (from IMF and EU assistance funds) to meet not only regular expenses but also to pay Serbian citizens almost \$119 million in free shares of the state-owned oil company, NIS. All of this had contributed to the dinar's depreciation, Stamenkovic said. In addition, the clash between NBS and the Government over the exchange rate had created negative expectations which increased pressure on the exchange rate. Media speculated that the public feud could be an attempt to replace Jelasic as NBS Governor, further fueling concerns about the dinar's stability.

Comment

19. (SBU) While Governor Jelasic claims that that value of the dinar is market determined, the shallow market for dinars makes effective coordination between NBS and the government essential. The Serbian exchange market is so shallow that a purchase of just \$30 million can significantly shake the exchange rate and public confidence. To date, NBS's monetary policy has helped to keep the financial sector stable through the economic crisis; however, the NBS and the GoS have consistently failed to harmonize fiscal and monetary policy. Jelasic has come under pressure in the past, but the public criticism from the highest levels of government has raised the natural tension between the NBS and the government to new highs. If the NBS and GoS cannot put their public feud aside and improve their coordination the Serbian economy, Serbian companies and the Serbian people will suffer. End Comment.
PEDERSON